THE STATE BAR OF CALIFORNIA
STANDING COMMITTEE ON
PROFESSIONAL RESPONSIBILITY AND CONDUCT
FORMAL OPINION INTERIM NO. 04-0002

ISSUE: Must an attorney comply with rule 3-300 when entering into a contingency fee agreement that contains a provision for a charging lien?

DIGEST: The inclusion of a charging lien in the initial contingency fee agreement does not create an "adverse interest" to the client within the meaning of rule 3-300 of the California Rules of Professional Conduct. Thus, an attorney entering into a contingent fee agreement need not comply with the requirements of rule 3-300 merely because the agreement includes a charging lien against any recovery in the case. Unlike a charging lien in an hourly case, the charging lien is a natural corollary of the contingency arrangement protecting the attorney while permitting clients to have access to the courts they may not otherwise be able to afford.

AUTHORITIES INTERPRETED: Rules 3-300 and 4-200 of the Rules of Professional Conduct of the State Bar of California.

Business and Professions Code section 6147.

STATEMENT OF FACTS

Attorney agrees to represent Client as a plaintiff in a personal injury suit arising from an automobile accident. Attorney and Client enter into a written contingency fee agreement providing that Attorney's fee will be 33% of Client's recovery if the suit is settled before trial, and 40% of the recovery if settled after trial commences.[1/] The contingency fee agreement complies with all of the requirements of Business and Professions Code section 6147. The agreement also provides for Attorney to have a lien on any settlement or judgment Attorney recovers for Client. Attorney does not advise Client to consult independent counsel prior to consenting to the fee agreement.

I. Contingency Fee Agreements

The negotiation of an original fee agreement is an arm's length transaction. (*Setzer v. Robinson* (1962) 57 Cal. 2d 213, 217[18 Cal.Rptr. 524]; *Cooley v. Miller & Lux* (1909) 156 Cal. 510, 524 [105 P. 981].) However, as a contract drafted by the attorney, its provisions are strictly interpreted against the attorney and any ambiguity is interpreted in favor of the client. (*Alderman v. Hamilton* (1988) 205 Cal.App.3d. 1033, 1037 [252 Cal.Rptr. 845].) Within these parameters, "the attorney is entitled to negotiate the terms on which he would accept employment as he wished . . . absent issues of duress, unconscionability, or the like." (*Ramirez v. Sturdevant* (1994) 21 Cal. App.4th 904, 913 [26 Cal.Rptr.2d 554].)

In California, contingency fee agreements are permitted for the pursuit of most civil claims and are generally favored because they allow access to the courts by persons who might otherwise have no opportunity for redress due to lack of resources to pay an attorney.[2/] In California State Bar Formal Opinion No. 1987-94 and again in Formal Opinion No.

[1/] We do not address in this opinion the impact of changes to the initial fee agreement or issues related to structured settlements. See, e.g., Cal. State Bar Form. Opn. No. 1994-135 [structured settlement of personal injury case creates conflict of interest requiring compliance with rule 3-300 when original agreement is silent on whether attorneys fees would be "front loaded" in the event of a structured settlement.]

[2/] *Fracasse v. Brent* (1972) 6 Cal. 3d. 784, 792 [100 Cal. Rptr. 385, 390] ["The client may and often is very likely to be a person of limited means for whom the contingent fee arrangement offers the only realistic hope of establishing a legal claim."]

1994-135 we observed that the California Legislature "has made entering into a contingency fee contract . . . exempt from the effects of conflict of interest rules because of public policy." The long-standing California rule mirrors the ABA Model rules.[3/]

For a contingency fee contract to be enforceable, the attorney must ensure compliance with certain safeguards. California Business and Professions Code section 6147 is designed to protect clients by requiring, among other things, that: (a) the agreement be in writing with a signed duplicate original provided to the client; (b) the client be notified that the fee is negotiable;[4/] and (c) the client be notified of the percentage fee as well as the manner in which costs and disbursements will affect the size of the fee and the client's recovery. In addition to statutory regulation of attorney fee contracts, contingent fees are governed by rule 4-200[5/], which states that an attorney may not charge an unconscionable fee.[6/]

II. Charging Liens

A charging lien, as defined by the California Supreme Court in *Fletcher v. Davis* (2004) 33 Cal 4th 61, 66 [14 Cal.Rptr.3d 58], is a lien "created upon the fund or judgment the attorney recovers for compensation in recovering the fund or judgment." In our factual setting, the contractual lien created by Attorney's contingency fee agreement with Client is a "charging lien."

Charging liens may be used to secure either contingent or hourly fees (*Cetenko v. United California Bank* (1982) 30 Cal.3d 528, 531-32 [179 Cal.Rptr. 902], thereby creating a "security interest" in the proceeds of the litigation. (*Fletcher v. Davis, supra,* 33 Cal. 4th at 67, citing *Isrin v. Superior Court* (1965) 63 Cal. 2d. 153, 158 [45 Cal.Rptr. 320].) The lien may be express or implied as use of the word "lien" is not required so long as the parties manifest an intent for the attorney to look to the client's recovery as the source of the attorney's fee. (*Id.* at p. 157.)[7/]

DISCUSSION

[3/] See ABA Model Rule 1.5 (c) ["A fee may be contingent on the outcome of the matter for which the service is rendered, except in a matter in which a contingent fee is prohibited by paragraph (d) or other law"] and 1.8 (I) ["A lawyer shall not acquire a proprietary interest in the cause of action or subject matter of litigation the lawyer is conducting for a client, except that the lawyer may: . . (2) contract with a client for a reasonable contingent fee in a civil case."] The ABA Model Rules may be looked to for guidance when they do not conflict with California rules. (See, e.g., Cal. State Bar Formal Opinion No. 1983-71).

[4/] Section 6147 is subject to certain exceptions not applicable to the facts we address. For instance, section 6147 does not apply to agreements for representation in worker's compensation matters. Bus. & Prof. Code, § 6147, subd. (c); Labor Code, § 4903, subd. (a). Contingency fee agreements related to claims against a health care provider are not governed by section 6147 but by another statute that establishes maximum contingency percentages and imposes different disclosure requirements on the attorney than does section 6147. [See Bus. & Prof. Code, § 6147, subd. (a)(4) and (a) (5).]

[5/] Unless otherwise indicated, all rule references are to the Rules of Professional Conduct of the State Bar of California.

[6/] See, e.g., *Shaffer v. Superior Court* (1995) 33 Cal.App.4th 993 [39 Cal.Rptr.2d 506]

[7/] We note that while a charging lien in a contingency fee case is favored by public policy, a retaining lien in which an attorney asserts the right to withhold the client file to secure payment of fees is not permitted in California. *Academy of California Optometrists* (1975) 51 Cal.App.3d 999, 1003 [124 Cal.Rptr. 668] [while *charging* liens may be freely created by contract, there is no authority permitting *retaining* or possessory liens on papers and personal property of the client coming into the attorney's possession]; Cal. State Bar Formal Opn. No. 1981-62 (attorney could withhold partially signed stipulation from client to induce client to pay fees); Restatement of the Law Governing Lawyers Third (2000) Sections 43(a) and 43(b).]

I. *Fletcher v. Davis*

In *Fletcher v. Davis, supra,* 33 Cal.4th 61 [14 Cal.Rptr.3d 58], the Supreme Court held that an attorney who wishes to secure payment of *hourly* legal fees and costs of litigation by obtaining a charging lien must comply with rule 3-300, which requires among other things that the attorney obtain the client's consent in writing. The court held that a charging lien in an *hourly* fee contract constitutes a security interest *adverse* to a client, thereby triggering the requirements of rule 3-300.[8/] In so holding, the *Fletcher* court noted that a charging lien was not inherent in the nature of an hourly fee agreement and that it was reasonably foreseeable that the charging lien could significantly impair the client's interest by delaying payment of the recovery or proceeds until any dispute over the lien could be resolved. The *Fletcher* court expressly declined to address the issue we discuss in this opinion, namely "whether rule 3-300 applies to a contingency fee arrangement coupled with a charging lien on the client's prospective recovery in the same proceeding."[9/]

II. Court Interpretation of Rule 3-300 and Its Predecessors

Rule 3-300 was enacted in its present form in 1989. From 1975 to 1989, Rule 5-101, the immediate predecessor to rule 3-300, was in effect. Rule 5-101 was substantially similar in its wording to the current version of the rule.[10/] From 1928 through 1975, rule 4 was in effect. Under rule 4, attorneys were *absolutely prohibited* from acquiring any interests adverse to a client: "A member of the State Bar shall not acquire an interest adverse to a client." Thus, until 1975, even fairness, notice and an opportunity to consult with independent counsel and written consent did not validate a transaction in which an attorney acquired an interest adverse to a client.

While rule 4 absolutely prohibited attorneys from acquiring any interest adverse to a client, the Supreme Court held that contingent fees were outside the scope of the rule. In *Isrin v Superior Court, supra,* 63 Cal.2d at 158-159, the court wrote:

> [I]n whatever terms one characterizes an attorney's lien under a contingent fee contract, it is no more than a security interest in the proceeds of the litigation. . . [T]he attorney's lien is 'an equitable right to have the fees and costs due to him for services in a suit secured to him out of the judgment or recovery in the particular action, the attorney to the extent of such services being regarded as an equitable assignee of the

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[8/] Rule 3-300 provides: "A member shall not enter into a business transaction with a client; or knowingly acquire an ownership, possessory, security or other pecuniary interest adverse to a client, unless each of the following requirements has been satisfied:

1. The transaction or acquisition and its terms are fair and reasonable to the client and are fully disclosed and transmitted in writing to the client in a manner which should reasonably have been understood by the client; and

2. The client is advised in writing that the client may seek the advice of an independent lawyer of the client's choice and is given a reasonable opportunity to seek that advice; and

3. The client thereafter consents in writing to the terms of the transaction or the terms of the acquisition."

The official Discussion following rule 3-300 states that: "Rule 3-300 is not intended to apply to the agreement by which the member is retained by the client, unless the agreement confers on the member an ownership, possessory, security or other pecuniary interest adverse to the client."

[9/] *Id.* fn.3 at p. 70.

[10/] Rule 5-101 was thus applicable only when an attorney entered into a business transaction with a client or knowingly acquired an ownership, possessory, security or other pecuniary interest *adverse* to a client. Like rule 3-300, it required fair and reasonable terms, notice to the client of the right and opportunity to consult with independent counsel, and written consent.

> judgment. It is based, as in the case of a lien proper, on the natural equity that a party should not be allowed to appropriate the whole of a judgment in his favor without paying for the services of his attorney in obtaining such judgment . . .' [C]ontingent fee contracts 'do not operate to transfer a part of the cause of action to the attorney but only give him a lien upon his client's recovery.[11/]

Likewise, Los Angeles County Bar Association Formal Opinion No. 496 (1998) noted that: "A contingent fee coupled with a lien against the client's recovery in the same matter in which legal services are being provided has never been held to require compliance with the terms of rule 3-300." Similarly, San Francisco Bar Association Formal Opinion No. 1997-1 stated that rule 3-300 was inapplicable to a standard charging lien in a contingency fee contract.[12/]

As Hazard & Hodes note in *The Law of Lawyering*, charging liens in contingency fee contracts are recognized as "almost universally permitted" and have been "historically uncontroversial." The authors point out that charging liens constitute "sound policy, for without . . . [them] a lawyer might find it necessary to take other protective measures during the representation, or to be more cautious about investing time or advancing costs. Thus, by offering the lawyer reasonable assurance in collecting fees and advances, liens . . . may actually *better* serve the client's interests, by eliminating a potential source of friction." (*Id.;* emphasis in original.)[13/]

Los Angeles County Bar Association Formal Opinion No. 416 (1983) reflects the difference between a charging lien, which applies to funds the attorney will recover for the client, and other types of security interests. In Opinion 416, the Los Angeles committee addressed a fee payable to new counsel entirely out of proceeds to be realized from a judgment *another lawyer* had previously obtained for the client. The committee opined that the fee arrangement would be permissible provided there was compliance with former rule 5-101. The distinction between that fact pattern and the one we consider in this opinion is that the security for the attorney's fee was not a fund recovered for the client through the lawyer's efforts, but rather was a separately created fund the client owned before the attorney was retained.

[11/] (See also, *Haupt v. Charlie's Kosher Market* (1941) 17 Cal.2d 843, 844 [121 P.2d 627]; *Bartlett v. Pacific National Bank* (1952) 110 Cal.App.2d 683, 689; *Jones v. Martin (*1953) 41 Cal.2d 23; *Cetenko v. United California Bank, supra,,* 30 Cal.3d 528; and *Epstein v. Abrams* (1997) 57 Cal.App.4th 1159 [67 Cal.Rptr.2d 555].)

[12/] No court has applied Rule 3-300 or one of its predecessors to a charging lien in a contingency fee case. Rather, the rule has only been applied where the risks assumed by the client were not inherent in the nature of the fee agreement. (See, e.g., *Ames v. State Bar* (1973) 8 Cal.3d 910, 917-919 [106 Cal.Rptr. 489] [the attorney's acquisition of a note secured by a first deed of trust was deemed an "adverse interest" to the client's second deed of trust against the same property prohibited by former Rule 4 because the attorney could summarily extinguish the client's junior lien]; *Silver v. State Bar* (1970) 13 Cal.3d 134, 139-140 [117 Cal.Rptr. 821] [an attorney's decision to levy on his own writ for fees against the client's ex-husband instead of levying on his client's writ for her judgment against her ex-husband violated Rule 4]; *Hawk v State Bar* (1988) 45 Cal.3d 589 [247 Cal.Rptr. 594] [an attorney who obtained a note secured by a deed of trust against the client's real property that could be summarily extinguished obtained an adverse interest in violation of former rule 5-101]; *Fletcher v. Davis, supra*, 33 Cal.4th 61 [a charging lien contains risks to the client that are not inherent, or common, in *hourly* fee agreements].)

[13/] Hazard & Hodes, *The Law of Lawyering* (2004 Supp.) §8.23, p.8-56.2, §12.21, p.12-59. See also, ABA Model Rule 1.8(i) (1) specifically authorizes lawyers to "acquire a lien authorized by law to secure the lawyer's fee or expenses". The Restatement of the Law Governing Lawyers, Third § 36 (1) (Official Draft 2000) also states that lawyers may contract with their clients for contingent fees and use liens to secure their fees and expenses. *(Op. Cit*., § 43.)

III. Differentiating between Charging Liens in *Hourly* Fee Contracts and *Contingency* Fee Contracts

Because the Supreme Court determined in *Fletcher* that charging liens in *hourly* fee contracts are a security interest *adverse* to the client, the Committee has considered whether the policy considerations underlying that decision should lead to the conclusion that rule 3-300 applies to contingency fees. Material differences between *hourly* and *contingency* fee contracts require a different analysis and lead to a different result.

First, a significant issue in *Fletcher* was the fact that the *hourly* fee agreement between the attorney and client was oral.[14/] The court therefore stated the issue before it as: "When an attorney wishes to secure payment of *hourly* legal fees and costs of litigation by obtaining a charging lien against a client's future recovery, must the attorney obtain the client's consent in writing?"[15/] Absent application of rule 3-300, there was no statutory or rule-based requirement that a charging lien in a *non-contingency* fee contract be in writing. In *contingency* fee contracts, on the other hand, Business and Professions Code §6147 provides an independent statutory basis, other than application of rule 3-300, that requires the agreement be in writing.

Second, in *Fletcher,* the Supreme Court noted that in the *hourly* fee context a charging lien "imposes risks and consequences beyond those inherent in a fee agreement."[16/] Because hourly fees are not limited in relation to the client's recovery, a charging lien in an hourly fee context could tie up the entire recovery pending resolution of a fee dispute between the attorney and client. That situation is readily distinguishable from a *contingency* fee contract where the charging lien is limited to the previously agreed upon percentage of the attorney's recovery. The contingency fee client is therefore protected by requirements that the fee be: (a) "decisive as to its existence and amount;"[17/] (b) subject to negotiation between the attorney and the client;[18/] and (c) limited in amount by common law principles governing unconscionable fees as well as rule 4-200.[19/]

Third, while charging liens impose risks and consequences beyond those inherent in an ordinary *hourly* fee contract, that is not the case with an ordinary *contingency* fee contract. To the contrary, a charging lien is an equitable corollary to, and thus inherent in, a *contingency* fee contract because: (a) the attorney and client have agreed that the attorney's fee will be limited to a percentage of, and derived only from, the recovery created by the attorney's work; (b) the attorney and client are sharing the risk of a recovery; (c) any fee the attorney earns will be delayed until the client obtains a recovery, usually the very end of the representation; and (d) the recovery often represents the only source of funds from which the attorney can ever be paid. For these reasons, charging liens are not only inherent in contingency fee contracts, they are almost universally found in such contracts. By contrast, charging liens are neither inherent, nor common, in *hourly* fee agreements where (a) there is no limit on the fee in relation to the recovery, (b) the client, not the attorney, bears the full financial risk of the costs of the representation, (c) the attorney may protect his or her right to be paid as agreed by requiring deposits or advances against fees as well as through pay-as-you-go arrangements; and (d) a breach of the

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[14/] Although oral, the fee agreement was enforceable because the client was a corporation. Business and Professions Code section 6148, subdivision (d)(4).

[15/] *Fletcher v. Davis, supra,* 33 Cal.4th at p. 64.

[16/] *Fletcher v. Davis, supra,* 33 Cal.4th at p. 71, fn. 7.

[17/] *Haupt v. Charlie's Kosher Market, supra*, 17 Cal. 2d.at p. 945; Bus. & Prof. Code, § 6147, subd. (a)(1) and (2).

[18/] Bus. & Prof. Code, § 6147, subd. (a)(4)

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[19/] See, e.g., *Jackson v. Campbell* (1932) 215 Cal. 103 [8 P.2d 845] ["If it had been contemplated that defendant should receive two thirty-five per cent fees, or a total of seventy per cent, for his services in trial and appellate courts, the contract should have so stipulated, although a provision for any such grossly excessive compensation in this case would have been so unconscionable as to raise the question of its enforceability."]

agreement by the client to keep current on fees owed to the attorney provides grounds for permissive withdrawal.[20/]

Finally, because charging liens are nearly universal in contingent fee cases, and virtually inherent in a contingent fee, if a client with a contingency fee contract were induced by a rule 3-300 disclosure to consult independent counsel about the charging lien before agreeing to it, the independent lawyer would likely confirm that charging liens are universally included in contingent fee contracts, that their inclusion in such contracts has consistently been upheld by the courts, and that the client would be hard-pressed to find a competent lawyer to take a case on a contingency fee basis without a charging lien. Thus, the client would have consulted with an independent lawyer, quite possibly for a fee, only to learn there was little reason to do so. The client's interests are adequately protected by the attorney's compliance with Business and Professions Code section 6147, rule 4-200, and other statutes, rules and case law governing the attorney's duties in this context. Requiring compliance with rule 3-300 in contingency fee contracts would cause clients to seek independent consultations without any discernible benefit.

CONCLUSION

An attorney entering into a contingency fee contract with a charging lien need not comply with rule 3-300 because the security interest is not adverse to the client within the meaning of the rule.

This opinion is issued by the Standing Committee on Professional Responsibility and Conduct of the State Bar of California. It is advisory only. It is not binding upon the courts, the State Bar of California, its Board of Governors, any persons or tribunals charged with regulatory responsibilities, or any member of the State Bar.

[20/] *Cazares v. Saenz* (1989) 208 Cal.App.3d 279, 287-288 [256 Cal.Rptr. 209]; *Isrin v. Superior Court, supra*, 63 Cal.2d at 158-159; *Epstein v. Abrams, supra,* 57 Cal.App.4th at 1170; Rule 3-700(c)(1)(f).